The Economic Club of New York

The Honorable Rainer Gut
Chairman of Credit Suisse

The Honorable Silva Herzog
Finance Minister of Mexico

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of New York

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Introduction

Peter G. Peterson, Chairman

Gentlemen welcome. Our program this evening is a bit unusual and I would like to make a few introductory comments to give you some of the background. One of the lasting contributions of the Nixon administration, one of many, I am sure, was their contribution to the colorful language of our country. And among the longer lasting contributions was the concept of a MEGO which you will remember stands for My Eyes Glaze Over. Now during that period, there were perhaps few MEGOs that glazed more eyes than the Third World. And today there are few more visible symptoms of the profound change in the global situation than the fact that depending upon whose eyes you are now looking at, at the Third World, the expressions in the eyes change from deep interest at the very least, all the way to profound terror at the other end of the spectrum.

The kind of questions that abound in every day newspapers in our country, you all know about. Are the Third World debts analogous to our federal deficits which in the eyes of many of us are structural, and then we can't and won't grow out of them. What kind of growth would it take in the OECD countries and elsewhere to permit the servicing of this debt?

At bottom, the question that is most often asked, I guess is, whether these debts are question of temporary illiquidity or whether there is an underlying large problem of viability. As another sign of our times, defaults were at one time not only unthinkable but unmentionable. Today, we hear of opposition parties in some countries. The talk about uniting behind a demand for a default. Others talk of a negotiated default which is a pleasant euphemism. We even hear words like, a debtors OPEC. What do all these words mean? Are they likely to happen? And what would they mean if they did? Not simply to the developed countries, but to the developing countries as well. What should we, or could we do about it? And when we say, we, who is it that we represents? It is for this set of reasons that your Board of Directors at a series of meetings felt that it might be useful to look at the Third World problem through at least three different sets of eyes. All wise and experienced eyes and heads, all deeply involved but with different perspectives.

First, we thought it would be useful to have the perspective of the Chief Executive of one of the world’s leading commercial banks. Banks of course being at the center of this global stage that is unfolding.

Second, we thought it appropriate to have the perspective of a developing or Third World country, a very large one to be sure, one of our closest neighbors, one of our largest trading partners, but also one that in recent times have been subjected to and from where I sit, has responded very well indeed to some of the financial pressures.

Third, we have the perspective of a very central player on the stage, the developed countries and in particular a person peculiarly in the middle, a representative of the central bank of the world's largest developed country. The Chief Executive of that institution. The New York Fed of course is the place where much of the international finance action, the foreign trading desks are located. So we have this tri-partheid, this triad of perspectives which will be added to, of course, by two very distinguished questioners and you know how independent they are, and I wouldn't even pretend to imagine what their perspective will be. Except I imagine that at times they will represent the general interest or the public's interest in this issue. First, I would like to introduce Mr. Rainer Gut. Many of you have read your program, I hope all of you, and you know that he is Chief Executive of a major bank. I must say, Mr. Gut I was interested to see that you were also designated as the speaker or the spokesman of your great bank. In our country, where we have about as many spokesmen as we do employees in most companies, we look upon that expanded role with profound envy and I congratulate you. (Laughter) That is said with some feeling in view of certain recent personal events. (Laughter and Applause) Mr. Gut is not simply the prototype of a banker's banker, having spent much of his life in that great institution, but of the global banker, with all of the perspective that it implies. And if I needed documentation, Mr. Gut, of your wide ranging knowledge and experience which I certainly didn't, I could hardly have had a more graphic example of your reasoning, tightly reasoned and broadly conceived article that I commend all of you, the *Nationalization of the Credit Business*. Mr. Gut, we welcome you to the rostrum of the Economic Club and we are delighted to have you from Germany. Mr. Rainer Gut. (Applause)

The Honorable Rainer Gut

Credit Suisse, Chairman

Thank you very much Mr. Peterson. It is a great honor to speak before such a distinguished audience, even though I have to clarify, the spokesman that was in my younger days, I since then, have been moved upstairs as Chairman. Certain similarities with you, I might say. Being the first speaker tonight, and knowing what is coming behind me, reminds me of an anecdote that is attributed to Sir Winston Churchill which I have to maybe adapt a little bit to the circumstance. He was once asked, what in his opinion will be the three most difficult things a man could be confronted with in his lifetime. And he replied, first is to climb a wall that leans against you, second is to kiss a girl that leans away from you, and third, be the first speaker before two on whom you depend and who know more about the subject than you do. (Laughter) Now I have never tried the first, and I am trying the third one now tonight. (Laughter and Applause)

Well it is beyond all doubt and I would like to get serious now that the debt problem is a very serious matter. The mere volume of the amounts involved show this. At the end of last year the international indebtedness of the non-OPEC developing countries amounted to approximately $600 billion US dollars and of that, approximately $300 billion can be attributed to Latin America. $200 billion alone to Brazil, Mexico and Argentina, $65 billion to the other non-OPEC Latin American countries and $40 billion to Ecuador and Venezuela. Whereas in 1980 the sum of restructuring totalled no more than $4 billion US dollars. We already saw in 1982 a ten-fold increase to $40 billion and it can be expected that the current year will bring its rescheduling to the tune of over $100 billion US dollars.

That is the consequence of a crisis situation in a strained international financial system for which a remedy must be found. Now let me just briefly get into some of the aspects how this came about. For a long time it looked at though the disruptions caused by the first oil price shock would be overcome without much harm being done. To all appearance the oil surpluses were being channeled back into fund seeking countries without any great difficulties. In any case the wheel of the international economy was kept turning and everybody, particularly us bankers; we patted ourselves on the back. The prosperity of the developing countries which benefitted from the inflow of private capital increased steadily up to a few years ago. For instance Latin America's Gross National Product grew at an annual rate of 5.5% in real terms in the 70's. Recycling, it is true was then facilitated by two factors, neither of which was unproblematic. First expansive monetary policies resulted in negative real rates of interest, accompanied by extremely low spreads. And this naturally made borrowing attractive. And second, the technique of the rollover credits opened up the efficient money markets for long-term financing. The fact that in this way the interest risk was shifted to the debtors did not seem significant at first, moreover in absolute terms, the borrowed sums were comparatively small at that time.

This changed when the world was hit by the second oil price crisis in 1979/1980 and major governments and central banks led by the Federal Reserve Board began to combat inflation with the utmost energy and to implement highly restrictive monetary policies involving extremely high levels of nominal and real interest rates.

The economy was driven to stagnation lasting for several years. Commodity prices crumbled and as a result terms of trade deteriorated to the detriment of the developing countries. Interest rates climbed higher and higher, and so did the mountain of debt since the rollover construction now caused a massive increase in debt servicing. The authorities of some developing countries nevertheless attempted to achieve growth rates that would have been normal only in an environment of a reasonably growing world economy. This resulted in huge gaps in the balances of payments and high inflation rates. Finally, in an effort to balance their budgets the governments of industrial nations cut their development date, the proportion of total indebtedness of the developing countries accounted for by official development dates of the industrial nations and soft loans of international development organizations declined from 33% down to 15% between 1971 and 1982. In parallel to this the share accounted for by bank credits rose from 12 to 34%. Many a financial expert warned at that time that such a trend would lead to increasing tensions in the fabric of the world's financial system. Despite the dramatic corrector of these developments, there can still be no question of a general world over indebtedness in my opinion. Today's country debt represents a much smaller proportion of GDP or exports of developing countries than it did of the United States at the comparable stage of development a century ago. Also numerous threshold countries in the Third World are still credit worthy. This applies at the moment not least to nations in the far east.

Now where do we stand today? Fortunately errors such as those committed in earlier periods of extreme tension in the financial markets, as for example in the 30's have been avoided this time. The central banks acted as is their role in such a situation and helped with undogmatic and unbureaucratic expeditedness to overcome the present liquidity crisis. And the world financial system is grateful to them for this quick action. For instance, the Bank of International Settlement played a very important role in this recent effort. The same may be said of those central banks that started flexible monetary policies. In such cases it is more important to provide liquidity than to adhere to rigid money supply targets.

The remaining measures such as increasing the general quota subscriptions to the International Monetary Fund and supplementing the resources under the general agreements to borrow also are important steps towards easing tension. So much for the international organizations and their policies of keeping a cool head.

Now what about the governments of the borrower countries? The other partner in the indebtedness debate. What attitude do they take? Until recently they were compelled to try and improve their external economy under extremely adverse cyclical conditions. In many places, particularly also in the country whose Finance Minister is also taking part in this gathering, remarkable progress has been achieved. This impressive performance incidentally exhibits dramatically that each country has to be measured and judged on its own merit. As an example of the improvement that has set in on the international trade front, I would like to mention the remarkable fact that in the last six months for which figures are available, the trade balance surpluses of the ten major debtor countries totaled about $3 billion, compared with the short fall of $5.5 billion in the respective period of the year before. True, the improvements in trade balances were brought about primarily through import restrictions. A step that by no means is unproblematic. For when capital goods, spare parts and know how become the victims of import cuts the country concerned is likely to be set back for years in its industrial development. In any case, such efforts cannot be repeated all too often. And are also not in the interest of the industrialized world who needs to export. In a second phase, trade balances therefore must on all accounts be improved by means of stepped up exports and this means additional new financing.

As regards current accounts, the progress achieved is much less manifest. The hopes entertained in this respect are dampened by the unexpectedly high level of US interest rates which rose again between May and August of this year. I do not want to enter in detail into the controversy surrounding the US budget deficit but I do feel that those voices should be taken very seriously who maintain that the enormous capital requirements of the American government are one of the principle reasons for the excessive interest rate level and for the dangers that threaten the world economy.

Whatever the case may be, the industrial nations have a duty to honor the efforts being made by borrower countries to meet both their financial obligations and also International Monetary Fund demands. They are responsible for ensuring first the access for the developing countries to their markets, is not complicated by all manner of protectionist measures, and second, that the incipient economic recovery will be of duration. This is made all the easier for the industrialized countries by the realistic attitude adopted by the borrower countries and most recently witnessed at the OAS Meeting in Caracas. Now the commercial banks, as the third partners, see the difficulties resulting from the continued disequilibria of the borrower countries. And the fact that the funds of the international organizations despite having been strengthened, are limited.

Private capital has been the single largest source of international financing, especially to Latin America and must continue to be in the future. Now this statement was made only very recently by Mark Cleland before the joint hearings of the subcommittee on the western hemisphere affairs and the subcommittee on international economic policy and trade of the foreign affairs committee in Washington. From this one can detect that high hopes are thus placed on the commercial banks. And we all would like to fulfill these hopes, but our possibilities are limited too. For on the one hand, we have to take into account our depositors who are beginning to become somewhat apprehensive. Now even in Switzerland, the internationally active banks which have relatively modest commitments in problem countries, and meets the highest capital adequacy requirements in the world, seem to have started losing some of their attraction for depositors of late in favor of the cantonal Banks. These banks, the cantonal Banks concentrate mostly on domestic business and they are primarily mortgage institutions enjoying a state guarantee for their deposits.

Recently therefore the big commercial banks were compelled for the first time in many years to pay higher interest rates than the cantonal Banks for their bonds issued. On the other hand, commercial banks, far and wide are subject to pressure by supervisory authorities, whose demands not infrequently conflict with the wishes of the monetary authorities. The banking commission would like to have the soundest banks and the central bank would like to have banks who cooperate internationally.

Nevertheless, the banks have renewed outstanding credits and granted a moderate volume of new loans. You could say we had no choice. But it seems to me as time goes on; the number of banks willing to provide new money is likely to diminish. What remains to be done therefore? It is obvious that all parties concerned are beginning to show some signs of fatigue. Moreover the political feasibility of the reconstruction programs will increasingly be put to the test. Finally, the borrower countries will, in the median term not be in a position to produce surpluses that will permit them to substantially reduce their foreign debts. Quite apart from the fact that the current account surpluses in developing countries ought to be the exception rather than the rule. These countries should not become exporters of capital on the contrary; they need new money from outside sources. The strategy currently being followed, however, seems to me correct. Without adjustment measures, no financial assistance. The reconstruction program should, however, be administered in careful doses, much as a certain amount of pressure is indispensable, it would nevertheless be wrong to tighten the screw unduly. Germany, a well known example experienced a terrible deflation in the 30's which led to a dangerous radicalization of society and as we all know, finally, to the collapse.

A similar radicalization triggered by economic need is by no means unlikely in some of the countries concerned. The International Monetary Fund seems to be aware of these problems. Indeed, it would be unfair to demand more from the developing countries than could be expected of the industrialized nations themselves. If one bears in mind what great difficulties had to be overcome by the far more robust industrialized nations in order to come to grips with the oil price induced loss of purchasing power and the inflation of the 70's then it becomes clear how heavy a burden the less stable threshold countries have to bear.

Seen from this angle, a more permanent solution to the indebtedness problem must be thought. The various sovereign debt discounting schemes are not the answer. They are in my opinion, unrealistic, and represent a crisis based action. That is just what we want to avoid. A bank that had discounted, in other words chosen the out, would not be prepared to provide fresh money and that is exactly what is needed in the present situation.

I shall try to be somewhat bold, knowing very well what is coming after me, but in my opinion, the solution should be thought in a three-pronged approach. First, the central banks, the International Monetary Fund and the other international organizations will have to continue providing liquidity and create conditions that will prevent the flow of capital to the developing countries from petering out.

Second, short-term debts to the banking system will have to be maintained at the present level and consolidated and its maturities stretched out.

And third, a guarantee fund should be set up by the United States and other western countries in favor of Latin America and other nations on friendly terms with the west. This will give the countries concerned time to adapt. The present hectic conditions in the field of restructuring could be avoided. Confidence would be strengthened, the constrictions on the capital markets will be loosened, and enhanced opportunities will be created for private investors to increase again their commitment.

Moreover, such a guaranty fund would contribute to its strengthening that part of the world, that is still free. And why should the West miss its chance of exploiting the economic and financial weakness of the Eastern Bloc when the Soviet Union and its satellites allow no opportunity to slip by of turning political discord among Western nations to their advantage.

The fear of new bouts of inflation seems to be unfounded. Since the debt situation would be eased, the guarantee would probably not have to be resorted to. And if it should, after all, prove necessary to make use of it, then the central banks would have had to provide liquidity even without such a fund in order to support the banks in their respective economies.

Finally, an easing of the constriction on the financial markets would help to bring interest rates down and particularly spreads, a development that is urgently desired. If United States interest rates were to stabilize at the level of 2 to 3% in excess of the inflation rate, the interest burden on the developing countries, bank credits could be reduced by more than $10 billion annually as compared with today's level. To this, easing of the interest rate burden would be added, markedly higher export proceeds. For in the course of the economic upturn, which would receive a boost from a fall in the cost of money, a perceptible and steady increase in the volume of world trade, could be expected. At the same time, commodity prices would probably regain much of the ground lost in recent years. The problem of international indebtedness would soon vanish from the headlines. Now this might all sound simple and easy and I fully realize to present the problem of the world indebtedness within 15 minutes is not that easy. But I am convinced that the international debt problem, which is at present primarily a problem of illiquidity, can be resolved but time is of the essence. And there, I am somewhat disappointed that things are not happening decisively enough. For illiquidity that lasts for any length of time will inevitably lead to bankruptcy. In any case, the seas will be stormy ahead, but in my opinion can be navigated if the powers concerned, namely the United States, assumes the leadership for quick and decisive action. Thank you. (Applause)

Moderator: Thank you Mr. Gut. Finance Ministers have never been known for their excessive candor. In fact, one of the oldest lines in Washington is, he was about as candid as a Finance Minister on the eve of a devaluation. (Laughter) As a result of this, some of you may think that a candid Finance Minister is an oxymoron. But let me read you what the *New York Times* had to say about our next speaker. Commenting enthusiastically about the clarity and frankness that soothed the tattered nerves of bankers, something I would have thought an impossibility, they said it sounded as if he was telling the truth. (Laughter) And this was a relief to businessmen who felt they had been repeatedly deceived about what was really going on. Now to many of us in the developed world, IMF conditionality is kind of an abstraction. It is a negotiation of a set of principles and defines responsibilities of the various parties.

Our next speaker knows firsthand what IMF conditionality is. He knows the economic pain, the political pain, and the human pain as few people in the world do. And I think Ross Johnson and I would agree that he also has a good deal of courage. Because the Finance Minister told us tonight that the problem got so serious that someone had to tell the truth to the Mexican people. And for one hour and ten minutes I believe he indicated or 20 minutes, he spoke the truth on nationwide television answering the questions that the Mexican people had about the sacrifices that were required. Given the remarkable job that he has been doing in the face of this relentless pressure, he is one that might be, and has been referred to as Mexican’s Silva Lining. One more attempt that has failed. (Laughter). I present to you, Silva Herzog a most distinguished Finance Minister. Minister Herzog.

The Honorable Silva Herzog

Finance Minister of Mexico

Let me express to you, at the beginning, my real pressure, my honor, to have the opportunity of expressing some words in front of such a distinguished audience. Mr. Gut mentioned three big challenges that Mr. Churchill mentioned at one time. I am taking the second one, (laughter and applause) and I am really happy about that. I was told that I was going to be the first speaker and I thought that probably this had a message. Central banks create the money, commercial banks lend it, and we debtors use it, and probably to be the first speaker was an underlying expression that you were very much interested in the repayment. (Laughter) So I am happy to be taking the second challenge that Mr. Gut referred to.

Things change very rapidly. The speed, sometimes it is even beyond what we would consider rational. I am sure that last year in your gathering of September or August or October at the Economic Club of New York, when Mexico was going through a very difficult time, probably I was not going to be invited. As a matter of fact, we have spent a week in Toronto at the IMF and World Bank Meeting. The previous gatherings we used to have a problem selecting with whom we were going to have breakfast, lunch, dinner, in Toronto, we had breakfast, lunch, dinner, by ourselves. (Laughter) I am really very happy that this year in your autumn September dinner you invited the Mexican Finance Minister to express to you some ideas about this basic problem that

has the headlines of most of the newspapers in the world.
I really thank you, and I consider it a recognition of that change that took place in one year time. Tonight, we are having dinner with a very distinguished audience and we thank you very much for that.

As it happens with important topics in the world, there is a high degree of misunderstanding about the problem of external indebtedness of most of the developing countries. The common interpretation is that this is the result of errors and lack of financial discipline. Errors on the part of debtors, we borrowed too much, errors on the part of creditors, they lent us too much. But I think that is a very simplistic and probably wrong interpretation of the problem. In a number of years the International Banking System with this recycling process had an excess liquidity and an excess supply of loanable funds and it was completely natural for the international banking community to look for some additional borrowers and these were a good number of the developing countries. A drastic change in the portfolio composition of the banks took place and a substantial improvement in the profit situation of a good number of banking institutions took place in those years.

Let me say in passing that this change in the portfolio composition of the banks is not something that will be able to be changed in a short run fashion. It will take time. Given the maturity of most of the lending process and the restructuring exercises that are taking place, the composition of the portfolio of most of the international banks of the world, will remain practically the same for a good number of years to come.

This is to underline one of the basic messages that I would like to transmit. That we are in front of the problem, that it is not going to be solved in the short run. That it will take some time on the part of debtors and of creditors, but nobody should think that from one morning to the next will be change or will be erased.

Why did we borrow such amounts of money on the part of developing countries? One, because of a political decision to try to foster development beyond what it was possible using our own resources. And even in the case of Mexico where we had such an increase in exports of oil, we thought and we took the political decision that we wanted to grow faster with the assistance of the foreign savings channeled through the foreign lending.

But second, and I think this is also very important to underline, is because there has been for a number of years a lack of dynamism on the export side of most of the current accounts of most of the developing countries. So, it was a way to supplement the domestic savings, the foreign exchange gap and to increase the rate of growth of our economies.

This is again a situation that cannot be solved on the side of the developing countries, on the side of the borrower countries, that cannot be solved in the short run. In order for a developing country, for a borrower country to reduce its debt, we have to generate, and Mr. Gut made a reference to it, in the last part of his message, we have to generate an external surplus to pay for the reduction in the foreign indebtedness. And I would not like to put too much emphasis that this is not a situation that has been frequent in the last few years, and that it is not a situation that could be obtained in an easy manner. So again, the external indebtedness problem from the borrowers point of view, it is a problem that will stay with us for a good number of years to come. And when we in our own countries are asked by political forces to reduce external indebtedness, we always have to answer that this will not be an easy problem to solve in the short run. We will have to generate this surplus in our external accounts, which means essentially that we have to cut back imports, but basically that we have to increase our exports to other parts of the world.

It is interesting to note that the external debt of a borrowing country has a natural rate of growth and this without taking into consideration other elements is given by the nominal rate of interest. If nothing happens in the rest of the economy, the foreign debt of a country like Mexico for instance, will have to grow at least, at least, by the amount of the nominal rate of interest. And if interest goes up, as they have gone in the last few years, the natural rate of growth of the external debt will also have to grow.

There is no question that foreign debt plays a very important and significant and positive role in the economic development process of a number of countries. The economic growth of a good number of countries who was financed partially by this transfer of financial resources from the international banking community to the developing countries. In Mexico for instance in the period of very high indebtedness, we were able to create for the first time in modern economic history, close to 1 million jobs a year. We were able to grow at more than 8% on a real rate, on an annual basis. We were also able to improve the income distribution of the country as measured by some of the economic indicators like the Gini coefficient. We improved somewhat, somewhat, the income distribution of the country.

But this very high rate of growth accompanied by expansionary policies that we followed during those years, led to a financial disequilibrium that was expressed mainly by an overvalue rate of exchange and at some point (CHANGED AUDIO SIDES) ... year capital outflow of the country. It also was expressed by a very high rate of inflation. And Mexico for the first time in our history had 100% inflation which if someone would have told us five years ago that we were going to have 100% inflation we immediately would have said, that probably they had made a mistake and they were referring to some other country more to the south. But we had 100% inflation and a very severe uncertain and lack of confidence for most of the remaining months of 1982.

There is no question that the foreign debt, and this is probably the highest risk, is that it permits a country not to do what it should do. It permits a country to maintain and overvalue rate of exchange and I think we are a very good example of that. It permits a country to maintain a number of subsidies that after a little while seem to be completely against the sound development of the whole economy. It permits a country not to act on the tax system in a more aggressive and adequate manner because you have the inflow, the assistance, the support, the contribution of the foreign savings that you get through the foreign lending.

How are we going to pay the debt? There is no question, and Mexico has made a reiterated expression that we want to fulfill all of the financial obligations and we are doing alright as far as that problem is concerned. But from the developing countries point of view, from the overall point of view, we certainly have to generate as I mentioned before, a surplus in what you might call a basic balance of payments, a basic balance payments, a current account, without interest payments and financial services. And this can only be obtained through reduction of imports, or an improvement in the export behavior of the economy.

We are cutting, as a short-run phenomena, as a short-run measure, we are cutting imports very significantly. We are right now about one-third of what it was in 1981. I was quite impressed by an expression that the other day I heard that had a lot of impact in the United States, saying that the reduction of Mexican imports from the United States had the effect or similar effects like the strike in the automobile industry in Detroit would have done in three years. We are cutting imports. As Mr. Gut mentioned, we have had to cut the spare parts, different machinery and equipment and there is no question that this had an impact on the rate of growth of the overall economy but we had to do it.

We used the best instrument of all. And sometimes I have been asked, what was the economic instrument that you used in order to bring down imports, and I have always answered that it is the best of all available. Which is not to have any dollars. When you don’t have the foreign exchange, you cut imports, definitely. That is what happened in the first quarter of the first four months of the year.

But this is not a sustainable situation. A country like ours, like many other developing countries with such a very high import content, in their industries, will have to have a better and a more adequate level of imports from the developed world. And in order to pay for them, we will have to increase our possibilities to export. And this is not definitely an easy solution. It is not a question only of protectionism, that the only problem is that the US or some other European countries have high barriers; it is a question that most of our economies are not export oriented. That we are not efficient enough, but I don't see in the coming years any other way to really have a positive and sustainable solution to the problem of external indebtedness without this higher dynamism in the export side of most of the developing countries.

There is also, and just, I am going to mention it in passing, a strong asymmetry in the economic policies of adjustment of the developed and the developing economies. We have to cut fiscal deficit and we are doing a very strong effort. In 1983 we are going to bring down the public sector deficit from 17% of Gross Domestic Product in 1982, which is almost an unprecedented coefficient, to 8.5% in 1983. And we are going to do it.

But in many of the very important industrial countries, the fiscal deficits are a very important force to keep interest rates up, which in turn makes the burden of the external debt much heavier for a good number of the developing economies.

What lies ahead? Just a few words. It is undeniable that foreign debt is a fundamental problem. It will leave its mark on the coming decades no matter how it is solved. It was not the result of a cataclysm but of a gradual process that at times had very positive results for the world economy. The developing economies grew at rates above those which could have been achieved in the absence of those capital flows. The developed countries, exports of capital, goods and services stimulated their economies, and raised the standard of living of a good part of their population. The problem requires a solution which goes beyond the pressure and the impatience of the short-run, the solution must be designed with long run criteria in mind. It is true that there are many countries which grew beyond their real capacities, and incurred more external debt than they could efficiently absorb. In these cases, an adjustment program, it is absolutely necessary. Not because it is a formula of an international organization, but because it is the only possible response to the economic reality. Many countries are presently implementing such a program, among them, Mexico. For the first time in history, international organizations, governments, central banks, and international banks are acting in a coordinated and very efficient manner. But it is not enough. Adjustment programs, restructuring of debt and the forced generation of an external surplus are necessary but not sufficient. Countries can tighten their belts for a while, but it is essential to find alternatives which allow their economies greater dynamism. There is no doubt that international capital outflows during the next few years will be smaller than in the recent past. In the absence of other means of acquiring foreign resources, the developing countries should grow less rapidly. As low growth cannot go on for too long, though if internal problems with international repercussions are to be avoided. Sometimes, one receives the impression that we are reacting to immediate pressures, limiting ourselves to extending payment periods and charging a little more, a broader vision, it is absolutely required. The responsibility for this task lies with the entire international community, both debtor and creditor countries should contribute their energies to avoid a collapse. Nobody should be excluded or exclude himself because partial solutions do not exist. The interdependence of the world asks for our solidarity and for the reestablishment of the basis of a balanced and just development, as a condition for international understanding and peace.

Thank you very much.

Moderator: Thank you Mr. Minister. Our next speaker is well named. He is a Solomon. He is wise, experienced, shrewd, educated. In fact he has degrees from both the University of Chicago and Harvard. What some of us would say is perhaps more education than a sensible person can take. (Laughter) Tony Solomon is a kind of renaissance man. He is obviously well educated. He has obviously had a remarkable public career. I first ran into Tony in Washington in a meeting with Wilbur Mills, who later became famous for other things, but during that meeting he was discussing trade in which he was obviously first among equals, and he said there are a few people in Washington you can trust, there are even fewer who even know what they are talking about, there may be only one whom you could both trust and does know what he is talking about, and that is Tony Solomon who played a remarkable role advising the Chairman on the ‘74 Trade

Act. I doubt if there is anyone in the United States who has more background than he to discuss tonight's subject. But what some of you may not know is that he has also been a very successful businessman. He spent, as you know, Mr. Minister, ten years in Mexico, eight years as President of a food company, later bought by General Foods. Thus, it was as natural as it was fortunate that these two friends were at the absolute center of the negotiation on that faithful weekend in August of 1983. I have left until last, what is perhaps his most noteworthy and remarkable achievement; he is also a Director of the Economic Club of New York. I present Tony Solomon. (Applause)

The Honorable Anthony Solomon

Director, The Economic Club of New York

Well I don't know whether to comment on Pete's introduction, I guess I will just skip that one and say that I think that there are many elements in both Rainer Gut's talk and Silva Herzog's with which I would agree, but I think if you listen carefully, if you are not too tired, this being the third talk tonight, you will notice some significant differences in our perspectives as to what the future pragmatically can hold. I think we are all familiar enough with the current debt situation, the current emergency as it is called, for me to dispense with that, in the interest of time. I would like to talk about what the world will be like after the current emergency is over. And before...let me define that a little bit.

I think of the current emergency as being roughly that period of time in which, at the moment there are 46 countries in IMF adjustment programs, exercising very severe austerity and emergency concertation and cooperation among central banks, private banks, government and of course all under the very close surveillance of the International Monetary Fund. But what comes after that, when the immediate crisis is over, the fear of a dramatic default has passed and we have to face the prospects of many countries of the world continuing to be burdened with very heavy levels of debt and the question of course arises, what kind of economic growth will they have, and what kind of social and political stability.

Now I have to say, simply because otherwise I get misunderstood, that before discussing the post-emergency period it does not mean that I am complacent about the immediate task of completing the necessary debt restructuring and carrying through basic economic adjustments. We have to make sure we sustain the kind of concerted effort by all of the principle participants which has yielded the tentative progress that has been made so far.

I think that we have to recognize that the degree of cooperation in this emergency period has been historically unique. I am very familiar with previous IMF programs, with previous debt rescheduling in the ‘60's in the ‘70's, and of course, the size of the problem has brought forth a very unusual response. More hard work, more political will, will still be required to get through this emergency period. But it can’t be successful unless the IMF can continue to play the pivotal role it has in binding together the different parts of this effort.

The fund will be unable to play that role if it is starved of adequate financial resources and political support. Frankly, I find it baffling that there are elements in this country and especially in our Congress who can ignore the catastrophic affects that would result from not acting now to make resources available to the IMF quickly. Without the IMF at the pivot, the whole debt restructuring effort would be undermined and needed new credits would be blocked. Outright defaults could actually happen.

In the longer run the consequences could also be grave. In fact I believe they would be grave. Debtor countries could be forced into a disorderly adjustment that will almost certainly include more protectionist measures, credit controls, price distortions and severe damage to local private sectors. It would injure the world trading system and seriously impair the prospects for economic growth. Not only in the debtor countries but here and everywhere else.

I believe that kind of major shift in policies in the Third World would bring about political moves to the left in justification and self defense. I do believe that the long-term consequences of failing to support the International Monetary Fund are extremely serious to the world as a whole. Even if you look at it in narrow terms, the direct cost to the United States alone would be enormous. Until last year our exports to less developed countries that now have debt servicing problems had been averaging $50 billion a year. Almost a quarter of our total exports.

How could it be rational for this country to risk giant price tags like these in the future and oppose the quota increase? Which incidentally does not even bear account on the budget deficit line. I know that there are those that don’t see it this way. Some look at the issue entirely in narrow financial terms, and conclude that the IMF can squeak by without the quota increase for the time being. That view is wrong, the arithmetic is wrong. And it misses the central point anyway. In the absence of clear, unequivocal support for the institution by the United States government, including the Congress, the fund will be permanently crippled. What is even more baffling is that among those who would cripple the fund, there are people who claim to be strong advocates of free markets. What they entirely fail to see is that the IMF in its efforts to get countries to pursue market oriented policies and to minimize the hodgepodge of distortions that undermine economic performance, is the best friend that market oriented people have in the kind of world we live in.

My strong sense is that the misguided opposition to the IMF quota legislation and the mischievous amendments that undercut it, will not prevail. I believe that ultimately the Congress will support the IMF and act positively to meet the international responsibilities of the United States. It is both an immediate and longer-term interest.

Suppose that we all do what we need to do in the short term. Then it is worth raising the question, what kind of economic prospects the developing countries, especially in Latin America, where the debt burden is greatest, can look forward to in a couple of years, possibly three or four, when the immediate emergency is behind, but not forgotten. Can they return to rates of economic growth that are reasonably satisfactory and broadly meet their aspirations for achieving social and political progress? I don't want to put specific numbers on this because growth potential differs from one country to the next. But I am talking about growth rates that would not be too far below the historical experience of most of the countries before the debt problem developed. It seems to me that it is certainly not impossible to get that outcome, but we have to face reality. There are going to be continuing constraints that will limit the scope for expansionary policies for some time to come as Minister Silva Herzog said. We can identify ways of easing some of these constraints and softening their impact. And we can be heartened by more optimistic developments lately in the industrial economies where the prospects for higher growth seem to be improving. But there still must be an expanded period in which the heavily indebted LDC governments are going to have very little margin for error. The most obvious constraint will be with respect to external financing. Conventional commercial bank lending will be much harder to come by. In the first instance that would limit countries ability to import and lower imports, particularly of capital goods will obviously hamper growth.

The natural question is whether that short fall can be replaced by greater official assistance from industrial country government. In my view, and although I am sorry to differ with Rainer Gut, that is not likely. While government officials have the will and resources to provide temporary support in a crisis, there really isn't much chance as I see the world today, of legislators going along with increases in long-term official funding, in amounts large enough to significantly offset lower commercial bank lending. After all, it was partly because of the difficulty of obtaining the official financing in the first place that borrowing from banks, the famous recycling, developed so much in the 70's.

Another question is whether the central banks of industrial countries, particularly the Federal Reserve, should provide large scale infusions of liquidity so as to ease credit availability for developing countries. Certainly in a crisis, central banks have a traditional responsibility as lenders of last resort to insure stability. And I think we have behaved that way. But any assistance of that sort must be strictly temporary. Central banks simply cannot be viewed as a source of median and longer term financing.

So what is left? By the process of elimination there are really only two alternatives. Either funds will have to find their way into developing countries through channels other than commercial banks, or borrowing countries will have to run their economies in ways that make them less dependent on external financing. In fact, the developing countries will have to move on both fronts, at the same time, if they hope to be able to achieve the satisfactory growth rates we are talking about.

Traditionally direct investment has been an alternative to bank financing. In calmer times, greater direct investment inflow should be an effective source of capital. To be sure we know the internal political opposition to direct investment has been strident in many countries from time to time in the past, and certainly could resurface as soon as the debt emergency starts to fade. Yet it seems to me that this manifestation of economic nationalism must be challenged and overcome if the developing countries are going to be serious about economic development in a period when new borrowing from commercial banks is constrained.

Improving financial management offers another important way for borrowing countries to cope with the constraints they are going to face. This should especially include efforts to diversify the currency composition of a countries debt. By choice or by necessity too much of the debt of any LDC's was in dollars. That left them vulnerable to a period of high dollar exchange rates and high dollar interest rates. We calculate that if from 1979 to 1982 developing countries have borrowed currencies in a diversified way, that is in proportion to their import shares, the LDC as a group today would be over $30 billion better off. I am not saying that this kind of benefit can be repeated in any particular time period in the future, but the clear lesson is that a more balanced and skillfully drawn portfolio debt is important. Of course that requires not only a willingness of borrowers to diversify but equally a willingness of market participants to modify their operations and the authorities in other industrial countries to allow it.

In addition, both borrowers and lenders have an interest in taking some potentially valuable financial instruments off the drawing board and getting them to market. To take one example, perhaps commercial banks could shift at the margin toward originating loans and then selling them off into a secondary market. Where price fluctuations would give useful, early disciplinary signals to sovereign borrowers. Or to take another example, I can visualize variable maturity obligations that offer a constant debt service flow in the face of any unexpected jump in interest rates, it is a kind of built in rescheduling.

There also may be a place in the market for securities with equity-like features, on which some part of the total yield to the investor could be calibrated for instance to the borrowing countries real GNP or export earnings growth, or some similar measure of economic performance.

Finally, there are a number of tools and techniques that are used by corporate borrowers here that are not yet being used by borrowers in developing countries. Just to give two illustrations, these instruments range from futures contracts to hedge against commodity fluctuations to interest rate swaps that can add another way of gaining fixed rate funding. In a period of restricted access to credit, it is worthwhile developing the expertise and sophistication to take advantage of the array of novel financing tools that are now available.

Innovations like those in the private capital markets would be helpful in ameliorating the financing problem, but I would not want to overstate the role that these mechanisms can play. It will not eliminate the need for major changes and reforms in general economic policies so that dependence on external financing is lastingly reduced.

The way I see it, there are three broad areas where policy reform in borrowing countries is called for to reduce dependence on external financing and promote domestic savings. After all, on average gross domestic savings finance 90% of LDC investment.

The first is in the balance of payments area. It seems to me that heavily indebted developing countries have to be resolute in keeping their exports competitive in world markets. First and foremost, this means following realistic exchange rate policies and not letting the domestic currency get out of line. It also means realistic interest rates in those countries to deter damaging flight of domestic capital. I cannot emphasize those two points enough. And I respectfully disagree with Minister Silva Herzog that there have been no errors along these lines on the part of many developing countries, including I am afraid, much of Latin America.

The second broad area is reform of government budgeting. To begin with, though it is getting harder for an American to preach to others on the subject, excessively large structural deficits have to be reduced. In addition, LDC governments must have tighter oversight of spending agencies. Closer financial monitoring of projects, better and more timely budget numbers and improved regulatory capabilities over their own financial institutions.

The third broad area is reform of the domestic price system. Every subsidy, every credit allocation scheme, every price distortion has to be tested against the standard of what it costs both in budgetary terms and in terms of economic efficiency. These are long-standing problems that existed well before the debt crisis and fixing any of them inevitably pits a government against powerful vested interests at home. But in the aftermath of the debt problem, there may be no alternative to meeting the task head-on because of the huge toll distortions take in limiting productivity and growth.

The governments in the industrial countries and the IMF both have to support LDC efforts to bring about market oriented reforms and better financial management. The industrial countries obviously have a major role to play in sustaining growth; in lowering global interest rates by reducing their own government deficits, and in keeping markets open for LDC goods. At the same time they have to open up their financial markets further so that the LDCs can diversify their sources of credit more effectively. They must help create a healthy world environment in which the LDC efforts can pay off, and there I certainly agree with both speakers before me.

As for the IMF, its role in managing crises is well recognized and indispensable. But treatment and cure are not longer enough. It must work harder and more effectively at prevention. What I see as close to being essential is that its surveillance role under more normal circumstances be enhanced. This has two dimensions.

First, the IMF should be assisting countries in improving their financial management. It can help them monitor their debts; it can work with countries to develop financial strategies, governing the currency and maturity mix of their borrowing as well as the degree of reliance on bank debt, on bond finance, direct investment and so on.

Second, appropriate IMF surveillance should extend well beyond matters of finance. The fund is not just a lender; it is a force for promoting sensible policies. I believe it should put its weight behind governments which are committed to a transition towards more deficient domestic price, interest rate and exchange rate policies. It must reject the argument that the IMF should focus only on a balance of payments target regardless of how it is achieved. These broader efforts by the fund should be an integral part of its regular consultation with all members. We don't want to go back to a situation where the IMF becomes deeply involved only after serious payments disruptions have occurred. That is too late, we have found. Instead a more continuous relationship would have some important advantages. It would improve the funds detailed knowledge of the constraints that regularly confront policy makers in each individual country. And it would provide a type of involvement by the fund that might head off some of the resentment and occasional hostility that can occur when the IMF is seen as an outsider, always prescribing austerity at a time of trouble.

To encourage movement in this general direction I would go even one step further. It would be worthwhile considering whether access to funding could be made more readily available by the IMF to countries that voluntarily participate in these financial and economic policy reviews should they have a balance of payments need later on.

In summary, we must plan for a world of tighter financial constraints, and less margin for error.

The approach I am recommending boils down to a combination of stronger market institutions and better market instruments, developing alongside better economic policies and stronger financial controls. In my approach there is no quick fix. There is no single scheme, or gimmick that will put these things right, and allow everybody to go back to business as usual. On the contrary I feel that those debt reshuffling schemes that you hear about, which look to industrial country governments to pick up existing exposure from the banking system are fanciful. It would be unjustifiably costly to the taxpayers and in fact they would give just the wrong signals; convincing people at home that a government bailout will always be there and whipping up pressures abroad in developing countries to ask for bailouts. What I am recommending is rooted instead in pragmatism. It basically seeks to rebuild. To build a more resilient system on the best features of what we have now.

And again I come back to what we have now pivots on the IMF. That is the institution which in practical terms binds a system together and which must play a more comprehensive role in the future. Therefore, the first step toward that kind of system is for the Congress to act quickly and positively on the IMF quota legislation and put to rest doubts about the commitment of the United States to a common sense, multilateral approach to dealing with the world’s financial problems.

Thank you very much (Applause)

QUESTION AND ANSWER SESSION

CHAIRMAN PETER PETERSON: Thank you Mr. Solomon. Now we come to our questions. And in the interest of time, I will not introduce someone who needs no introduction. Dr. Henry Kaufman, as first questioner. Henry.

MR. HENRY KAUFMAN: Thank you Pete. We have heard just now a very fervent plea by Mr. Solomon for the approval of the quota by the United States that sits before Congress. But let us assume for a moment the worst, that somehow this is not approved. I would like to ask, perhaps each of our three speakers what steps and what measures should then be initiated by other official institutions, by the commercial banks and the central banks in order to breach this gap?

THE HONORABLE RAINER GUT: Well that is an easy one. From my vantage point, it is inconceivable that these quotas will not be approved. But let's assume they will not be approved. I think I told in my brief remarks that I don't think the commercial banking system will be just simply able to provide or to fill the gap. And here again I don't think it will be up to the commercial banks to fill the gap that is provided by the International Monetary Fund. For me, this will be a crisis situation which would immediately call for action by the central bankers and they would have to primarily put their heads together and come up with a solution. I think there is one thing that is not realized and I didn't probably make clear enough in my remarks; I think it is too much expected from the commercial banking system.

PRIME MINISTER HERZOG: Well I think that is like a projection on interest rates. (Laughter and applause) I certainly will coincide with Mr. Gut that this will be a critical situation. In the case of Mexico, the conversations and the support we got from the International Monetary Fund was completely decisive and fundamental to the beginning of the recovery of our economy. I think we are one of the good examples of how the financial support but also the kind of backing from the economic policy point of view that it is attached to an IMF program, I repeat we are one of the best examples of what the IMF can do for a developing country that gets into trouble. We entered into negotiations with the IMF in August of 1982, and we concluded on the 23rd of December of last year. We definitely agree that, that permitted to negotiate a global package that included a good number of central banks, through the international bank for the bank for international settlements and a good number of commercial banks from all over the world. I think the center, the point that permitted to tighten together all of this cooperation was precisely the International Monetary Fund. Not because the International Monetary Fund was telling us what we should do, I mentioned in my remarks that the recipe was established by the Mexican authorities themselves. But there is no question that the IMF permitted this global and concerted effort that I think we have had for the first time in modern history. So I think that the IMF would be able to play this technical role or this support of the economic policies of the countries involved, but the gap of their financial support would be more difficult to fulfill on the part of the commercial banks and probably there would be a demand on other governmental institutions that probably will make things a little more difficult. So we certainly considered almost as Mr. Gut mentioned, unbelievable that the increasing quotas in the IMF would not pass.

MR. ANTHONY SOLOMON: Under statute the US Treasury Exchange Stabilization Fund which is the only resource available and the Federal Reserve are prohibited from any formal lending, direct or indirect, to the IMF unless the Congress legislates. So you have a situation where, if the quota legislation failed to pass, there would be of course, immediate panic around, I can only see the European Central Banks and the Japanese Central Banks stepping in to fill a little bit of that gap temporarily, if they thought that the United States would reconsider its action. That would involve at least as big a commitment by the President of the United States to supporting that legislative effort as say the MX missile or merit education teachers pay. (Laughter) I suppose that in that kind of scenario if the President of the United States were to say that this all a great mistake, there is no question the Congress will pass it and I will do everything necessary to make sure that the Congress passes it. That you might get then some temporary funding coming either from central banks or from IMF borrowing in private capital markets, which they can do to a certain degree. But that is no...there is no possible long wind solution to a failure by the Congress to pass the quota increase. And I would assume that if there were such a failure, if it were protracted for, I don't know what period of time you are talking, but let's say a year or two, if we had that much of a breathing space, I would assume that with a rash of debt restructuring failing, new money not coming in, that the world would be in such bad shape that there would have to be a world emergency conference to go ahead and do what we should have done in the first place.

PETER PETERSON, CHAIRMAN: Mr. Thornton Bradshaw.

MR. THORNTON BRADSHAW: Well, I am impressed that all of the speakers have put the IMF at the center of the possible resolution of the international dilemma and there seems to be an assumption that the Congress will pass the bill. It seems to me that is a pretty weak read on which to rest the entire weight of the world. I would like Mr. Solomon perhaps to continue with what he had started to say which is what are the politics behind what you have called the misguided, mischievous opposition to the IMF quota legislation and what can we do about it?

ANTHONY SOLOMON: Well I am no great expert. Any journalist covering Washington can probably handle that question as well as I could. But, you know there are some well-known platitudes around in political circles that you don't win any votes running for Congress by being for foreign aid and this gets called foreign aid, even though it doesn't really affect the budget deficit. See what most people don't understand that whenever the IMF draws on the US dollar letter of credit, it automatically adds to our official foreign exchange reserves. It is like going out of one window into another window. So it doesn't affect the budgetary deficit bottom line. In other countries, they don't require parliamentary action because of that. It is thought of as basically something within the authority of the central bank, but in our country, it does require Congressional action. I feel that we have developed an unfortunate habit in this country of many members of Congress reflecting pressures from the population in different groups of wanting to hit their pet causes from any vehicle they can. Any legislative vehicle they can. If you look at this incredible list of amendments that have been put on, particularly on the House side, you will see that people are trying to cure the apartheid problem in South Africa, they are trying to cure the communist problem abroad, they are trying to cure what they think are excessive spreads on bank interest rates, through a very involved system whereby you compare that to what you would charge a Triple A domestic borrower and then if the bank charges more than that, then it has to go to...the excess has to be given to the Secretary of the Treasury. You have a lot of strange amendments. And if you ask me what are the political reasons which bring this about, I guess it is a combination of one the constituents are really ignorant of what is a relatively technical question. It can get easily dismissed as foreign aid. People have hobby horses to ride and push their own special views, many of which are justified. But, is it appropriate really to use a vehicle like the IMF for achieving both incredibly narrow and incredibly broad unrealistic objectives and goals. Now you asked finally in your question what can be done about it? I would like to think that educational efforts by members of congressional constituencies are of course always helpful. I don't really know what else can be done about it. Obviously the President can weigh in. I indicated that earlier, more than he has. And I assume he will be forced to. I don't think that the legislation will necessarily fail or that these amendments will not be either eliminated or so modified that one can live with them. I mean, there is another amendment for example that says the United States must oppose, I am not sure of the exact language, but any quota increase until all of the civil servants of the IMF cut their salaries, accept salary cuts down to where they are no higher than US civil servants. Of course you lose immediately the entire senior management of what is the most critical institution that all of our prosperities depend upon. Now who is kidding whom that there is a relationship, a cost/benefit relationship there. But somebody has a hobby horse to ride. I could go on like this for a long time and I am taking too much time, sorry. I don't know how to solve the problem, except by exposing I suppose the idiocy of some of this stuff and the absolute crucial essentiality and importance of it to the rest of the world and to our own prosperity. (Applause)

HENRY KAUFMAN: Mr. Gut, in your presentation you gave a very interesting exposition of the events that led up to this problem. Among the things you cited there were rollover credits, negative interest rates and then Minister Herzog said that large inflows of loans permit a country to do what it should not do. Now in view of all of these confluence of events, what do you think the potential role of commercial banks should be or should have been under those circumstances?

PETER PETERSON, CHAIRMAN: Mr. Gut if you answer that honestly, like me, you may not be a Chairman very long. So...(Laughter)

THE HONORABLE RAINER GUT: Well, a bold man as I am I shall try and answer it to the best of my knowledge. I think if you go back to the time when the first oil shock happened, there were all kinds of study groups put together of bankers, of intellectuals, economists, and they all came up with the same conclusion. They all said, this shift of substance from one side to the other, cannot be financed on the back of the private system. We have to find some kind of multinational, supranational body to do it. Well nothing happened. And the banks finally stepped into the gap. 1979, 1980 happened, and we were proud of ourselves, the world was proud of ourselves that we had done it so efficiently at such a minute spread, Mr. Minister, (laughter) and all of a sudden, all these things were happening which we had warned would happen. And it seems to me that it is easy to criticize the banks, but somebody had to do it, and the fact that you asked the question before, what is going to happen if the IMF is not going to do it, I am 100% convinced the banks are not going to do it this time, because they have been criticized so much for what they have done in the past that they will not offer the other cheek for the next hit. I think it is a very simple situation. I think if we banks would have behaved according to what sound banking dictated us to do; the situation would never have arrived at the present point. But you would have had to realize that all of these countries including the industrialized world, which is later on governing to that process, would have had to start tightening their belt much earlier and we would have prevented a lot of hardship which we are facing now. (Applause)

THORNTON BRADHAW: A question for Minister Herzog. I think all of us recognize that the President de la Madrid's austerity program has produced phenomenal results. At some social cost, however. Do you see a weakening in the political support for the program if inflation and unemployment are not significantly reduced by the end of the year?

PRIME MINISTER HERZOG: I think I should answer it no. We were faced with a situation early December of 1982 with a situation that was very critical. We had a public sector deficit of 17% of gross domestic product. It is difficult to find some other precedent in some other country with such a high coefficient of a public sector deficit that is as high as the one we had last year. We had 100% inflation. And we had a current account deficit in 1981 that was close to $15 billion. So we didn't have any other choice but to enter into a very severe adjustment program. We are cutting expenditures; we are increasing revenues in order to bring down deficits. We tried to figure out what other way there was to correct the high fiscal deficit and we look and look and look and there is no other way but to reduce expenditures and to increase revenues. So we increased revenues through taxation, and through increasing prices of the most important commodities that were offered by the public sector, mainly oil, which was very heavily subsidized. We are going to conclude 1983 with a very substantial reduction in our fiscal deficit. We are going to conclude 1983 with an 8.5% which is practically half of what it was last year. We are going to bring down inflation, not as much as we had expected at the beginning of the year. There we had failed. We thought we were going to be able to bring down inflation to 55% or 60% and probably we will end the year with something around 75% which is still a significant drop from the one we had last year. And where we had had the most significant improvement is in the external account. We are having a surplus in the current account and most likely we will end 1983 instead of a $3 billion that we had estimated at the beginning of the year, we most likely are going to end with something between 1 and 2 billion dollars surplus. We are going to have a surplus for the first time in 40 years. It is an interesting phenomenon but let me remember that last year when we were discussing this kind of a problems we were told, well look you should increase revenues, reduce expenditures, and to do many of the things that we are doing. Recently, there has been a worry about the social and political instability. We don't have any doubt that the solidarity of the Mexican society can remain. It has remained so far with a very severe adjustment problem. Through political messages, through very close contacts with the most important sectors in the economy. And so far, we haven't had any significant problem in Mexico. There are some exceptions that will happen with the adjustment program or without the adjustment program. I drive my own car, and I walk on the streets by myself. But, there is no question that this would not be a sustainable situation forever. How far, it is very difficult to say it. But we definitely think that a country like Mexico with 75 million people, half of it with poverty standards cannot have an economic growth like the one we are going to have this year of minus something. Probably we are going to grow minus two, minus five. We will be able to accept it, and to tolerate it because we have had 40 years of expansion. Because of this political structure that we have in the country. But I would say that this very severe adjustment program cannot last forever. Next year we should aim for a more modest growth so as to be able to absorb the growing population. And if this adjustment program will remain for three, four, or five years, I definitely agree that we might face some additional problems besides the pure economic ones. Thank you. (Applause)

PETER PETERSON, CHAIRMAN: Alright, we will have one final question from each questioner. Henry.

HENRY KAUFMAN: I would like to ask Tony Solomon the following. Because the US dollar is the key reserve currency of the world, the United States must play an important role in the international monetary system. Well to what extent has the Federal Reserve or for that matter the American Government, the responsibility to be the lender of last resort to the international banking and monetary system?

ANTHONY SOLOMON: I assume that at this late hour you want a pretty quick answer to that. (Laughter) Let me say briefly we think that...as has more or less been worked out for the last decade among central banks that each central bank must play the lender of last resort role for its own banks. Now obviously if there is a dollar liquidity problem, it is possible that some of the industrialized country, central banks, may have a liquidity shortage when it comes to dollars in playing the lender of last resort role to their own banks. Now, if there were a legitimate need for dollar liquidity, we do have a very large international swap network that all of the industrialized countries pretty much have with the United States, with the Federal Reserve, and it would probably be quite appropriate to permit the activation of those swaps to meet their dollar liquidity needs in exercising the lender of last resort role to their own banks. I do not see a situation where the US as such would play in any direct sense a lender of last resort role to all the banks in the world, or all the banks in the industrialized countries or all the banks that are heavy in the international lending business. It would seem to me that this would be both the practical and more equitable way of sharing the lender of last resort responsibility.

PETER PETERSON, CHAIRMAN: Alright, the last question.

THORNTON BRADHAW: I think each speaker in discussing possible solutions had one common ingredient and that was the need for time. Suppose time runs out. And this is the question I should say is addressed to Mr. Gut. Suppose time runs out, is there a chance for a major default by a third world nation? And what would that mean?

RAINER GUT: Well if time runs out, it is for me, absolutely conceivable that there will a default by a major country and what that means in my opinion, it is not going to rest with one single country, it will spill over to other ones. And in the ultimate, I could see that you would go back to the days of compensation payments and different currency zones and we would be back in the middle-ages. And at that particular moment I would think that the Federal Reserve system would have to be the lender of last, last resort. (Laughter and applause)

PETER PETERSON, CHAIRMAN: I would like to close this excellent meeting with two pleasant, pleasant chores. First of all, Mr. Minister, having heard about your sorry plight, I wish we could have presented you with a solid gold 18 karat apple that you could have, forgive the expression, liquified, but we wanted this as a personal remembrance to you Sir, the great symbol of New York, and of course we will do that for each of our other guests. Thank you very much for coming.

Now in closing this program, which is my last one, I would like to not only thank all of you for the great privilege of being your Chairman but thanking you for your forbearance and your patients. You have absorbed without public protest, at least, my persistent, futile, and my wife would say pitiful attempts at wit which alas were not redeemed by humor. The Directors were so anxious to avoid this tragedy in the future that they insisted that the new Chairmans attempt at wit must be redeemed by humor. So this Thursday, Mr. Minister you will forgive me if I say this, we will have a Mexican type election. The outcome is reasonably certain. (Laughter) And not only will the wit be funnier, but I am sure we will have great leadership and I would like to introduce to you, your Chairman-elect, which is the last time this year I plan to announce my successor as Chairman, (laughter) Mr. Ross Johnson, President of Nabisco Brands. Ross Johnson (Applause) Thank you all again, and goodnight.

End of Meeting